A Remarkable Resemblance

Germany from 1900 to 1945 and China today. Time for a NATO for trade?

BY ROBERT D. ATKINSON

The issue of China trade has taken up most of the trade policy oxygen for the last four years as the United States and China deepened their trade war, and it is unlikely that a new Biden administration will go back to a pre-Trump era *vis-à-vis* China trade. Yet crafting the right response to China's unrepentant "innovation mercantilism" is difficult because it appears the free world has never faced such an adversary before.

But in fact, the free world has faced such an adversary: Germany for the first forty-five years of the twentieth century. As noted development economist Albert O. Hirschman wrote in 1941, Germany was neither a free trader nor a protectionist. It was a "power trader" that used trade as a key tool to gain commercial and military advantage over its adversaries. Likewise, China's trade policy is guided neither by free trade nor protectionism, but by power trade, with remarkably similar strategy and tactics to those of 1940s Germany. Understanding how Germany manipulated the global trading system to degrade its adversaries' capabilities, entrap nations as reluctant allies, and build up its own industries for commercial and military advantage, just as China is doing, can shed light and point the way for solutions to the China challenge.

HIRSCHMAN'S ANALYSIS

Hirschman's first but largely forgotten book, *National Power and the Structure of Foreign Trade,* was published in 1945. It was the rise of Germany as an economic and military power, both leading up to World

---

Robert D. Atkinson is President of the Information Technology and Innovation Foundation.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

War I and again in the 1930s under Hitler and National Socialism, that led Hirschman to focus on the unique nature of German trade policy. From that experience, Hirschman wrote: "[I]t is possible to turn foreign trade into an instrument of power, of pressure, and even of conquest. The Nazis have done nothing but exploit the fullest possibilities *inherent* in foreign trade within the traditional framework of international economic relations."

Germany was neither a free trader nor a protectionist. It was a "power trader" that used trade as a key tool to gain commercial and military advantage over its adversaries.

Hirschman's key insight was that some countries— in this case Germany under three very different government regimes from 1900 to 1945—focus not on maximizing free trade or even on protecting their industries, but on changing the relative power of nations through trade to achieve global power. Germany's policies and programs were designed not only to advance its own economic and military power, but to also degrade its adversaries' economies, even if that imposed costs on their own economy relative to a free trade regime.

As Hirschman pointed out, neither the free traders (such as the United Kingdom) nor the protectionists (the United States before President Wilson and the 1913 Underwood Tariff reductions) were interested in changing the relative power of nations. Free traders believed that trade was a welfare-maximizing, win-win process where all nations benefit, otherwise why would two parties engage in it? Protectionists assumed other nations would be protectionist and that only the distribution of activity would change, with nations getting more of some economic activity and less of other.

Hirschman argued that there were two main sources of Germany's trade power: the supply effect and the influence effect. For the supply effect, Germany concentrated imports on goods need for its war machine, redirected trade to neighboring friendly nations or subject nations, and sought to control oceanic trade routes.

Germany also engaged in substantial industrial espionage to boost its own supply capabilities. As *New York Tribune* journalist Stanley Frost wrote in 1919, "German inventions are to be kept secret—others are to be stolen. Trademarks are to be pirated." He also discussed how German engineers were sent oversees seeking work in foreign enterprises to engage in a "vast espionage system." And just as today's U.S. Department of Justice has opened hundreds of investigations into Chinese industrial espionage, the department also investigated Germany then. As Attorney General Mitchell Palmer wrote in 1919, "In many of the large German companies taken over by the Alien Property Custodian [set up when the United States entered World War I], it was found after investigation that espionage was one of the chief functions."

On the influence side, Germany sought two effects. The first was to make it more difficult for its trading partners to dispense entirely with trade with Germany, thus creating dependency. As Hirschman writes, "If [country] A wants to increase its hold on B, C, D, etc., it must create a situation in which these countries would do *anything* in order to retain their foreign trade with A." Hirschman notes that a dependent country has only two choices: dispense entirely with the trade they conduct with A, or replace A as a market and source of supply with other nations, something that is not always easily done, at least in the short term. Germany consciously sought to make countries dependent on its exports, including chemicals and machinery. It did this by directing trade to poorer nations, developing exports in articles that other nations were dependent on, introducing a wide disparity between patterns of production for exports and imports, and creating vested

Germany's policies and programs were designed not only to advance its own economic and military power, but to also degrade its adversaries' economies.

interests in trading partners and tying those interests to continued trade with Germany.

The second way to achieve influence was to make it more difficult for trading partners to shift trade, in part by driving the prices of their exports to Germany up, including through monetary manipulation and by focusing on promoting exports of highly different products not only to create dependency but to limit the ability of other nations to advance industrially.

As Hirschman writes, "It was one of the great principles of German foreign economic policy to prevent the industrialization of her agricultural trading partners." He went on to note:

> *The frequent dumping of German goods abroad was not seen as an instance of differential price policy practiced by a discriminating monopoly. It was supposed that dumping served a policy bent on destroying competition in the foreign market so as to secure a monopolistic position for German exporters.*

Organizing trade and economic policy around power principles is difficult because it requires considerable coordination of economic actors, many of whom would otherwise prefer to act differently. Germany was able to do this because the state played a significant role in directing and coordinating Germany's private sector enterprises. For example, as Frost wrote, "Change in ownership in protective industries [those key industries targeted for state support] and also the appointment of their higher officers are subject to the approval of the state." Germany also sheltered its protective industries, knowing that through state pressure, German firms would not use the respite from domestic competition that the state provided to benefit shareholders, but rather to spend the excess profits to pay for dumping exports at below-market prices.

It wasn't just Hirschman who characterized German trade and economic policies this way. French economist Henri Hauser wrote in 1915 that

> *Germany made war in the midst of peace with the instruments of peace. Dumping, export subsidies, import certificates, measures with respect to emigration, etc., all of these various methods were used not as normal methods of economic activity, but as means to suffocate, to crush, and terrorize Germany's adversaries.*

Attorney General Palmer wrote that German trade power tactics included: "Destroy business competitors by state aid, cartel combination, dumping, full-line forcing, bribery, theft of patents and inventions, espionage, and propaganda." A 1919 article in the *New York Times* quoted a U.S. chemical engineer arguing that in Germany, "relentless industrial aggression will be inaugurated and all the evidence points to a thorough and painstaking organization to ensure permanent success."

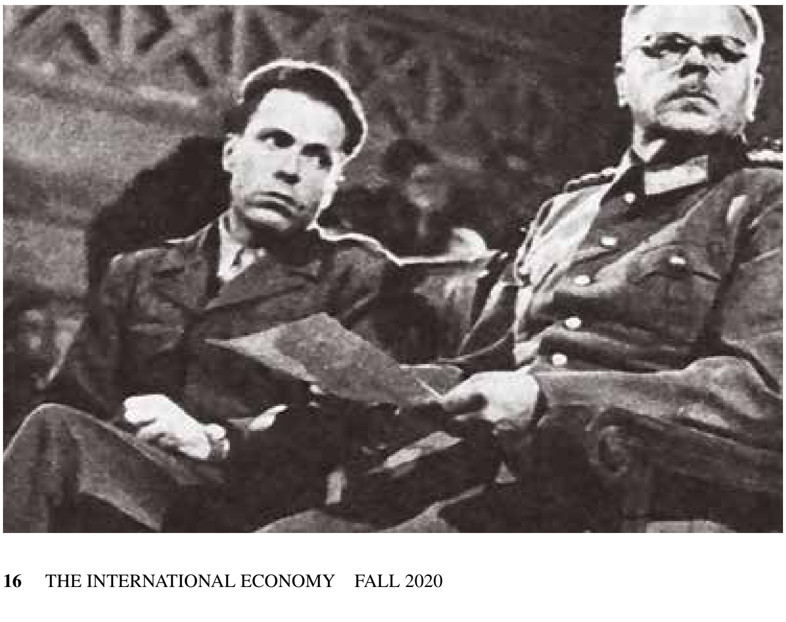
Even German officials described their efforts in similar power terms. In his 1918 book *The Future of German Industrial Exports,* Siegfried Herzog described trade in military power terms:

> *Because the weapon [German industry] is so terrible, because German industrial genius is showing itself superior to all opposition, hostile ingenuity in the future will direct itself before all else toward undermining the mighty bulwark of the German pile. After all, we cannot blame the enemy so much, but we must make his molehill work thoroughly unpleasant for him.*

CHINA'S POWER TRADE REGIME

When the World Trade Organization was formed in 1995, the assumption among virtually all trade experts was that the world was entering a new free trade era, with the ultimate elimination of both borders and "beyond-the-border" trade barriers. Tom Friedman's "flat world" was just around the corner, with all the benefits from it: peace, prosperity, and stability.

It was with this hopeful—even utopian—vision that China was welcomed into the free trading club in December 2001. When China entered the WTO, pundits and policymakers enthusiastically hailed it as a seminal moment that heralded China's embrace of market-based economic



Albert O. Hirschman *(left) serves as interpreter at the trial of German General Anton Dostler for war crimes in 1945. That same year, Hirschman published* National Power and the Structure of Foreign Trade.

principles and commitments to the core tenets guiding liberalized trade and globalization. Then-President Bill Clinton argued that free trade would liberalize China and make it more democratic, like the United States. Nick Lardy, now at the Peterson Institute for International Economics, spoke for many when he said, "The big winner is the United States—or at least American corporations. The United States has few carrots to offer the Chinese to sign a deal… The economic benefits of WTO membership for China are relatively meager."

This made sense as long as the prevailing conceptions of trade were between the poles of protection and free trade. After all, by joining the WTO China was giving up some of its autonomy over trade actions and was agreeing to lower tariffs.

In reality though, this was like letting the ravenous fox into the free trade henhouse, for while perhaps some government officials intended to turn China more in the direction of free trade, the power traders, especially under President Xi Jinping, have prevailed. Ironically, entry into the WTO helped enable China's way to power trade status, in part because prior to that the United States, China's biggest market and soon to be its biggest investor, could easily punish China economically by not extending China's annual Most Favored Nation trade status. Once in the WTO, it was safer for U.S. firms to invest in China, knowing that their exports back to the United States would be secure, and it was safer for China to misbehave because now the United States had to go through the complicated and rule-based WTO process to take action against China. Yet because most of China's power trade tactics are opaque and not rules-based, it is difficult for the WTO to effectively discipline China. Coupled with the fact that China retaliates against any U.S. firm with China operations or sales that presses the U.S. Trade Representative to bring a WTO case, this means that the WTO has been limited in constraining power trade tactics.

The United States needs to take steps to ensure a strong non-Chinese supply of rare earth minerals, as well as provide incentives for companies to move some supply chains out of China.

Power Tools

The theory of power trade better explains China's economic and trade policies than does the theory of free trade or protectionism. China employs its vast array of policy tools to use trade to increase its relative economic power not only over the United States, but over other nations that it seeks to influence as it strives to become the new global hegemon.

—R. Atkinson

So what does China want? As China scholar Orville Schell summed up in his book of the same title, the same thing Germany did: wealth and power. For China, the two are inextricably linked. This is what Chinese President Xi was saying when in 2015, he unabashedly trumpeted a goal of making China the "master of its own technologies," by which he meant that Chinese firms, operating in China, would produce virtually all technology goods and services for Chinese consumers.

As such, the theory of power trade better explains China's economic and trade policies than does the theory of free trade or protectionism. China employs its vast array of policy tools to use trade to increase its relative economic power not only over the United States, but over other nations that it seeks to influence as it strives to become the new global hegemon.

In his book, Hirschman described pre-war Germany concentrating its imports on goods needed for its war machine, redirecting trade to neighboring friendly nations or subject nations, and seeking to control oceanic trade routes. China has done the same. It has constantly focused on reducing export controls of technologies that would boost its national security. Through its Belt and Road initiative and its Regional Comprehensive Economic Partnership trade agreement, China has sought to bind nations in the region to it. And by state dictate and subsidy, it has built the world's largest commercial shipbuilding industry and now has the world's second-largest commercial shipping industry.

Like Germany, China used a suite of policies to create dependencies to provide it with protection against trade retaliation. It used predatory practices to reduce the non-Chinese global supply of rare earth minerals, and then subsidized its own producers to gain a global monopoly, which it then used not only to force foreign companies to produce in

Continued on page 53

Continued from page 17

China if they wanted market access, but to force foreign nations to abide by its wishes. By massively subsidizing manufacturing in China, including through currency manipulation, free land, tax incentives, cheap loans, and cash grants, China induced the offshoring of critical manufacturing sectors to China, as the United States has seen when it needed to obtain surgical masks and ventilators during the Covid-19 crisis.

Just as Germany made less-developed nations dependent on it for natural resource and commodity exports, China has focused on exporting manufactured goods while importing commodity goods, ideally in such quantities as to create foreign dependencies. As Hirschman wrote, "A nation pursuing a power policy may be assumed to export industrial goods and import mainly those articles for which it either has no substitutes at home or only poor and expensive ones." China has become the go-to market for many developing nations seeking to export raw materials. This risks turning nations such as Chile and Australia into dependent vassal states, worried that China could cut off their exports at any time. China used the same tactic when it threatened to cut off U.S. agricultural exports in order to pressure the Trump administration to make trade concessions.

Because most of China's power trade tactics are opaque and not rules-based, it is difficult for the WTO to effectively discipline China.

Just as Germany created vested interests in trading partners and tied those interests to continued trade with Germany, China has done the same, enabling key economic interests in many nations to gain sweetheart deals with China, in exchange for fealty to China.

Just as Germany engaged in monetary manipulation to reduce its export costs, for many years China relied on currency manipulation to become the world's manufacturing workshop. And just as Germany frequently "dumped goods" overseas to either prevent the industrialization of potential competitors or to deindustrialize existing competitors, China mastered the practice of selling below cost in order to gain global mastery in industry after industry, including shipbuilding, telecommunications equipment, solar panels, and steel.

Just like Germany engaged in substantial industrial espionage, China has perfected this, enabled by a global internet that lets it reach into foreign nations and steal vast quantities of intellectual property, supplemented by reliance on Chinese foreign nationals working at foreign firms.

Like Germany, China targets key industries in which it seeks global dominance. The Germans called these protective industries. China calls them "strategic and emerging" industries.

And just like Germany, China uses that economic power to achieve political gains, which it supplements with coercive, "wolf warrior" diplomacy. For example, China pressured Barbados to remove the Queen as its head of state, using the leverage it has over Barbados from the massive loans China has given it. Likewise, China has threatened to cut off Australian imports of pork and minerals in order to cow them into submission on foreign policy matters.

And just as "Germany made war in the midst of peace with the instruments of peace," so too has China as a means to "suffocate, to crush, and terrorize its adversaries." As Brookings scholar Rush Doshi writes:

> *China is pursuing a robust, state-backed effort to displace the United States from global technology leadership. This effort is not driven entirely by commercial considerations but geopolitical ones as well. Beijing believes that the competition over technology is about more than whose companies will dominate particular markets. It is also about which country will be best positioned to lead the world.*

China has clearly pursued power trade with smaller, less-developed nations. A key point for Hirschman is that nations need to structure their trade in a way that not only maximizes their economic welfare, but reduces their vulnerability to the economic and trade power of other nations. This is why he says it is in the interest of smaller states to diversify their trade away from dependence on a larger state. Conversely, it is in the interest of larger powers to concentrate their trade with smaller nations, so those nations' choices are few. This is China's strategy particularly with nations in southeast Asia that are participating in its Belt and Road initiative.

Even though this strategy increases dependencies for both China and other nations, these are more than manageable. In part, this is because China follows Hirschman's advice that the key is to direct manufacturing exports to countries that are poorly suited to produce them and therefore are dependent on the exporter. According to Hirschman, to "prevent the industrialization or even the removal of already existing industries is an important part of trying to

Just as Germany engaged in monetary manipulation to reduce its export costs, for many years China relied on currency manipulation to become the world's manufacturing workshop.

preserve or to increase the influence acquired in these countries by an industrial nation."

And while Hirschman was talking about less developed nations, this is the goal of China *vis-à-vis* the United States, especially in the battle for strategic and emerging industries, including 5G equipment, artificial intelligence, quantum computing, and other areas. And China succeeded in the "removal of existing industries" when it accelerated the offshoring of significant components of U.S. manufacturing in the 2000s.

In writing about Germany in 1941, Douglas Miller, former U.S. commercial attaché to Germany, could easily have been writing about China today: "We must get this straight once and for all: There is no such thing as having purely economic relations with the totalitarian states. Every business deal with them carries with it political, military, social, propaganda implications."

China pressured Barbados to remove **Queen Elizabeth II** *as its head of state, using the leverage it has over Barbados from the massive loans China has given it.*

IMPLICATIONS FOR TRADE POLICY

Ultimately, Germany stopped being a power trader—and shifted to a mix of free trade and protectionist industrial policy—after it was defeated in World War II. We can only pray that the relationship with China does not follow a similar path.

What then are the options? Hirschman identified two. The first is autarky, with nations building up their own economies so that they are less dependent on power traders. But he rejects that as the solution because the economic welfare losses more than offset the relative gains in national sovereignty. But some short-term trade-offs must be part of the solution regarding China, especially on national security grounds. For example, the United States needs to take steps to ensure a strong non-Chinese supply of rare earth minerals, as well as provide incentives for companies to move some supply chains out of China (as Japan recently did with its incentives program). It also means adopting a more robust advanced technology strategy to build up critical capabilities domestically.

Hirschman's preferred solution, however, was that the "power to organize, regulate, and interfere with trade must be … transferred to an international authority able to exercise this power as a sanction against an aggressor nation." Writing before the creation of the General Agreement on Tariffs and Trade in 1947, Hirschman wrote that nations should seek to "build a new framework of international relations in which the use of foreign trade for purposes of national power would encounter more difficulties than hitherto." But he noted that to make this possible, "the complete autonomy of national commercial policies must be effectively limited," and the institutional framework of foreign trade, including export-import banks, be internationalized.

The West, led by America, waited too long to use its power to compel China to change its economic and trade policies.

Yet even when it was working most effectively, the WTO never came close to having such power. Moreover, the WTO was created with the idea that nations were either free traders or misguided protectionists. And by joining the WTO, the idea was that protectionists would be, for the most part, turned into at least mostly free traders.

The WTO was not set up to deal with power traders, which makes constraining Chinese power trade difficult. With its one-country, one-vote system, coupled with the difficulty of enforcing opaque, non-rule-of-law power trade policies in the WTO, the options for it constraining China's power trade are limited.

Because of this challenge, one option some propose is to turn to protectionist solutions. Hirschman anticipated this response when he wrote:

> *It was only too easy to exploit the possibility of "economic aggression" by sovereign nations as an argument against free commercial intercourse. The demand for increased protection seemed to be much more compelling and much less oriented toward mere vested interests if the evil portrayed by the protectionist was economic aggression and penetration rather than foreign competition.*

Yet that doesn't mean that the claims of power trade are unfair and an unwarranted guise for protectionism. To be sure, the risk of protectionist backlash is real. After World War I, when the allied powers debated what to do regarding Germany, there was widespread agreement that Germany's destructive power trade regime had to be dismantled. The allies, according to Hirschman, worried that Germany had the "object of establishing the domination of [their enemies] over production and the markets of the whole world, and of imposing on other countries an intolerable yoke." Some proposed fighting fire with fire and argued that the allies should adopt German-style policies and practices writ large. Others, like Hauser, took a more nuanced approach, making a distinction between "what we shall not imitate from Germany" and "what we shall have to imitate."

It means the formation of a "NATO for trade" to more effectively counter Beijing's strategy of picking off trade adversaries one at a time and bullying them into submission.

China has clearly pursued power trade with smaller, less-developed nations.

To respond, the Allied governments agreed to adopt "all the measures requisite on the one hand to secure for themselves and for the whole of markets of neutral countries full economic independence and respect for sound commercial practice and, on the other hand, to facilitate the organization on a permanent basis of their economic alliance." But as Hirschman details, this generated protectionism and economic defense, rather than economic offense to limit future German practices. Rather than generating "an economic alliance between the Entente countries [that] could have led to the planning of a strong nucleus for future international collaboration… it was the nationalistic and restrictive *spirit* of the Paris Conference which prevailed."

The risk today is that a recognition of the realities of China power trade could lead to a similar, equally harmful response. But that doesn't mean that recreation of the prior one-sided free trade regime with the United States open and China a power trader. That would further accelerate the harmful effects of Chinese industrial aggression. As Hirschman wrote, the free trader assumptions of neutralizing power trade through more free trade "are not merely 'unrealistic' but utterly fantastic." But he does note that it is important to strive for free trade on the grounds of economic welfare, but the expectation of fully achieving it, especially *vis-à-vis* a power trader, is minimal. In the U.S. context, this might entail some short-term hits to economic welfare, as the United States restricts trade with China while concurrently rebuilding lost industrial capacity in order to neutralize America's dependence on the Chinese market and diminish the latter's power trade advantages.

One reason why dealing with China's power trade is so difficult is that the West, led by America, waited too long to use its power to compel China to change its economic and trade policies. In the late 2000s and early 2010s, the hope was that China's joining the WTO would do that. But at that point, China was much more dependent on foreign technology, and strategic and coordinated export controls could have crippled much of the Chinese technology economy, with that threat providing key leverage over China. Today, that opportunity is largely gone. Now China is near parity in many technologies so that it can afford to reject any American economic aggression, albeit not without economic pain, but without economic catastrophe.

Hirschman got it right when he rejected both the views of the free traders who refused to acknowledge that power trade could be practiced, and the protectionists who used the fear of power trade to justify protectionist policies. He wrote:

> *Between those who ignore the danger of external economic relations becoming an instrument of national power aims and those who see the danger but try to remedy it by the defensive and offensive weapons of economic nationalism, a place should indeed be left to those who, faced with danger, refuse to follow the policy either of the ostrich or of Gribouille* [someone who naively sees the adversary as innocent].

The only real solution to confronting the most dominant power trader in history is to use a multitude of tactics. This means that allied nations need to do a better job of supporting their own advanced and critical industries through smart, coordinated industrial and technology policies. It means stronger alliances and deeper trade pacts among free-trading nations.

It means closer collaboration between allied nations to push back on Chinese predatory power trade practices, including increasing foreign aid to help developing nations avoid crippling dependency on China and better coordinating export controls and inward investment reviews.

It means that a "coalition of the willing," led by the United States, should name and shame other nations that are unwilling to make even modest economic sacrifices to help constrain China power trade, rather than free riding on the efforts of a few nations, such as Australia, the United States, and, it appears, the United Kingdom.

It means the formation of a "NATO for trade" to more effectively counter Beijing's strategy of picking off trade adversaries one at a time and bullying them into submission. This new organization—call it the Democratically Allied Trade Organization (DATO)—should be governed by a council of participating countries, and if any member is threatened or attacked unjustly with trade measures that inflict economic harm, DATO would quickly convene and consider whether to take joint action to defend the member nation.

In summary, we should not reject free trade ideals. But we should also not be blind to the harsh reality that the world now is distorted by the world's strongest power trader: China. The answer is not deglobalization. It is not protectionism. It is not holding on to the naive hope that free trade could prevail if the United States simply "ends the trade war" (started by China). Rather, allied nations need to understand the adversary they face, and respond bravely, strategically, and expeditiously. ◆